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ABSTRACT

This booklet for secondary students contains background information and activities about the multinational corporation (MNC). The major goal of the booklet is to impart an understanding of the economic concepts underlying the world economy and the activities of multinational business enterprises. The world economy, the exchange of goods and services among countries, has always been a part of our lives. However, today it is more important than ever. The volume of world trade has expanded over eight times since 1960. Growth in world trade has been accompanied by a remarkable growth in multinational business enterprises. These organizations account either directly or indirectly for an increasing number of goods and services we consume daily. The modern multinational corporation has a presence in foreign countries for three basic reasons: (1) to satisfy its own and others' needs for raw materials, (2) to produce at lower cost in order to meet competition and to satisfy its customers, and (3) to conform to government policies of the host country. Brief reading selections provide students with information on world trade, history of MNCs, the economics of MNCs, and some issues raised by MNCs. Following the readings students are involved in many activities. For example, students compile a list of commodities that the United States must import from other countries and prepare exhibits, bulletin boards and/or reports describing the origins of these products and their uses in the U.S. In another activity students log all the products advertised on a TV station within a certain time and determine how many of them are made by MNCs. Students also participate in role-playing, panels, large and small group discussions, and independent research. Pre- and posttests are included. (Author/RM)

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The World Economy and Multinational Corporations

An Activity Program for Grades 9 through 12

ED195481

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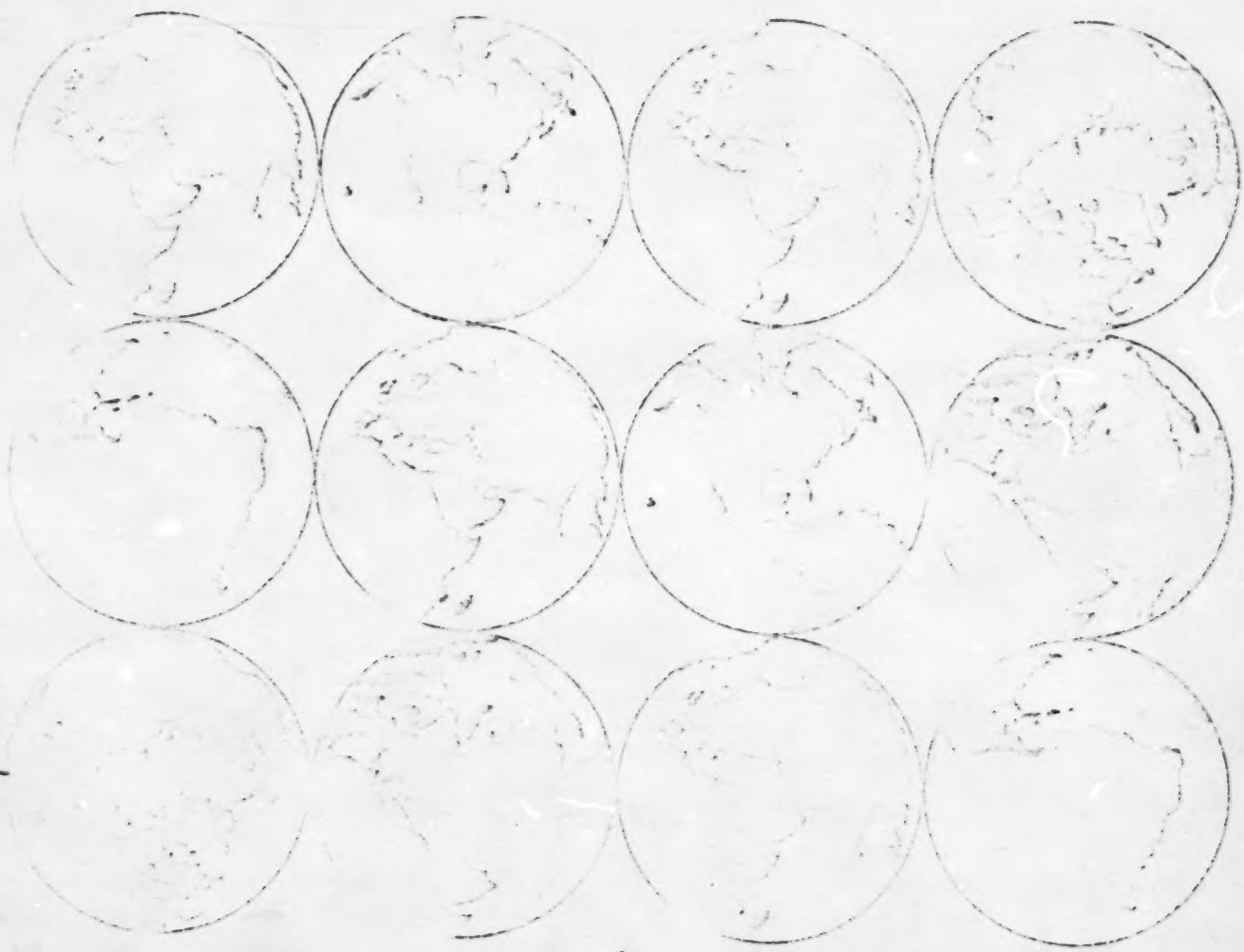

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Preface

The teaching of economics in our schools and colleges has often slighted international economics. There is some reason for this neglect. Until recently, very little of our Gross National Product was made up of "exports." But this situation has rapidly changed. While still a small portion of our total output of goods and services, the international sector is growing daily, and Americans are increasingly concerned with such matters as the balance of trade and balance of payments.

Particularly important has been the growth of businesses known as multinational corporations. Viewed with some suspicion by many educators, these organizations are growing rapidly and account either directly or indirectly for an increasing number of the goods and services we consume daily.

The purpose of this booklet is to provide teachers with some basic information about the multinational corporation (MNC) and some related ideas about international trade. Hardly any material available in economic education deals with this elusive but interesting subject. Hence the present work might be the first of its kind.

New concepts such as "global education" and innovations in business education, social studies, consumer education and home economics necessitate an understanding of the complexities of decision-making among business enterprises and countries. These innovations also suggest that we educators should be able to help students understand the ways in which MNCs affect our daily lives as consumers, workers and citizens. Designed to bring this understanding, this booklet contains background materials for the teacher and interesting spirit duplicating master activities for high school and junior high school students. We hope you find them informative and useful in your classroom.

Dr. Michael MacDowell
Executive Director
Illinois Council on Economic Education

Foreword

This booklet is intended to impart an understanding of the economic concepts underlying the world economy and the activities of multinational business enterprises. The authors hope that the perspectives offered in this booklet will help students understand the world economy and multinational business enterprises as they are—not necessarily as they ought to be. The latter judgments can be asked for, but, only after one has an understanding of the economic and political environments in which the multinational corporation exists.

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SECTION I—A NOTE TO THE TEACHERS ABOUT THIS BOOKLET

Introduction

The world economy, the exchange of goods and services among countries, has always been a part of our lives. However, today it is more important than ever. The volume of world trade has expanded over eight times since 1960. Increasingly, American-made products are sold abroad and foreign-made items consumed here. Growth in world trade has been accompanied by a remarkable growth in multinational business enterprises. This booklet will help the teacher better understand these enterprises, the role they play, and the circumstances surrounding them.

Teachers who use this booklet need not have a great deal of training in economics or business to be able to benefit from it. The material has been designed as an instructional tool for them and their students. The booklet contains explanatory materials, suggested lesson plans, spirit masters, and tests to help teachers of grades 9 through 12 deal effectively with the increasingly important institution of multinational corporations.

The booklet is organized so that background materials are presented first to prepare the teacher to deal effectively with the topic in the classroom. Materials are also included that provide opportunities for students to participate in a variety of learning activities such as role-playing, panels, large and small group discussions, and independent research. These activities may also help students develop more positive attitudes towards learning and towards themselves as students.

Objectives

After carefully reading and studying the background information on the multinational corporation and the economics necessary to understand the role of multinationals in world trade, students will have achieved the following:

1. A knowledge of the fundamental economic concepts related to world trade.
2. An understanding of the magnitude of world trade and the contribution of the multinationals to world trade.
3. A knowledge of the definition and dimensions of the multinational corporation in the world economy.
4. The capacity to analyze the economic, social and political factors that cause many business enterprises to become multinational.
5. An appreciation of the new problems that face countries and business enterprises because of multinational production, distribution and ownership.

This booklet contains spirit duplicating masters from which 200 or more copies of student materials can be made. These are designed to complement the other materials and activities in the booklet. Another important component of the booklet is the evaluation instrument which is also contained in spirit master form.

USING THE PRETESTS AND POST-TESTS

Effective instruction requires pretesting. By carefully examining the results of the pretest, teachers can identify what students know. If most students get certain questions right, teachers need not teach the material again but simply remind students occasionally of what they know and reinforce that learning. On the other hand, if students all miss a certain group of questions then the teacher knows where remedial work is necessary. There is a great deal of evidence that better learning and easier teaching follow from greater awareness of what the students know at the beginning of a unit.

The teacher may wish to explain what the pretest is used for and to reassure the students that it will give them some idea of the kinds of material they will be studying. Thus, the teacher must have a good idea of what is to be taught with this material before beginning to teach it. Experienced teachers realize that it is good practice to tell students what they will be learning and how it fits into what they learned in the past and is related to what they will be learning in the future.

After completing the materials, give the post-test. Teachers may choose not to use the post-test for assigning grades. If it is used for grading, however, the students should be told. If the results of the post-tests are not to be used for grading, the teacher can allow the students to grade their own tests and discuss the answers in the class. This technique of using the test as a learning experience can be used with either the pretest or the post-test or both. And, of course, having the class grade its own papers saves the teacher time and provides immediate feedback to the students.

Finally, the teacher should review the results of the post-test either individually or with the entire class in order to show the students what they have learned and not learned. After this review is a good time to introduce the next unit of study and make the connection between what the students have studied and what they will now be beginning to study.

What You Can Expect To Learn In Section II

1. That world trade has grown significantly in the past decade.
2. That world trade is significant in absolute terms.
3. That world trade is relatively more important for some nations.
4. That most trade is carried on among developed nations.
5. That the principal products traded reflect both high technology production and the world's need for energy and raw materials.

NOTES FOR THE TEACHER ABOUT SECTION II

This section contains basic introductory material related to world trade. Several tables are included which provide information about the nations of the world and the products produced and sold among them. Tables 1, 2, 3, and 4 lend themselves to a discussion of the growing dependency of nations upon one another and how developing nations manifest their lack of development in their lack of participation in world markets. These lesser developed nations usually do not produce enough to sell to people outside their country. Tables 5 and 6 show who trades with whom and what kinds of goods are exchanged and why. The activities at the end of the section suggest several ways of prompting activity and discussion that will help students to reinforce their understanding of the nature and magnitude of world trade.

World Trade

World Trade refers to the transfer and exchange of economic goods and services across national boundaries. Trade among countries is important for several reasons. First, many jobs are dependent upon the sale of goods in other countries. Markets for goods are not restricted by national boundaries and sales are larger, which means more jobs are available. Second, trade helps all nations get the goods and services that they may not have, such as oil, nickel, copper, bananas or computers. Third, trade is important because it enables countries to specialize in the production of those goods and services which they produce best, since countries know they can exchange their goods and services for other goods and services produced in other nations.

The absolute amount of trade among nations has expanded rapidly over the last three decades as the figures in Table 1 indicate. Increased affluence in the world, especially in the developed countries, increased dependency on oil shipments from the Middle East, and improved transportation and communication networks—these are some of the more important reasons for this remarkable growth.

Table 1. Selected Trade Statistics Since World War II, The World And The United States (Billions of Dollars)

	Total World Trade	United States	
	Exports	Exports	Imports
1950	58.0	12.1	10.1
1955	88.2	15.6	12.5
1960	119.1	20.6	16.4
1965	174.2	27.5	23.2
1970	311.3	43.2	42.4
1975	875.1	106.2	103.0
1976	991.1	115.0	129.6

Source: International Monetary Fund *International Financial Statistics* and United Nations, *Monthly Bulletin of Statistics.*

As might be expected, nations both sell goods and services outside their country (export) and bring goods and services into the country to be consumed (import). In addition to the United States, some of the other important world traders and the magnitudes of their exports and imports are shown in Table 2.

Table 2. Magnitude Of Trade Of Some Of The World's Leading Traders, 1975 (Billions of U.S. dollars)

World Trader	Exports	Imports
European Economic Community	363.7	391.1
West Germany	91.6	75.6
France	52.2	54.2
Canada	31.9	34.3
United States	106.2	103.0
Japan	55.8	57.9
Oil Producing Countries (OPEC)	112.0	53.1

Source: United Nations, *Monthly Bulletin of Statistics* December, 1976 Vol. XXX, No. 12. Table 52, pp. 110-117.

Although the United States continues to be the largest world trader in terms of dollar value traded, exports constituted only 7.0 percent of the total dollar value of U.S. output of goods and services produced in 1975. This number indicates that people outside the United States buy 7 percent of the goods and services we produce. It is significant to note that even though the United States contributes the greatest absolute amount of world trade, it ranks near the bottom among major countries in percentage of its production sold abroad. The following table illustrates this point.

Table 3. Total U.S. Dollar Value Of Exports And Percent Of Gross National Product Exported By Selected Countries, 1975

Nation	Value of Exports (Billion Dollars)	Gross National Product (GNP) (Billion Dollars)	Export as a Percent of GNP
Belgium	28.8	63.1	45.6
Netherlands	35.1	80.8	43.4
West Germany	91.6	423.9	21.6
United Kingdom	43.8	244.8	17.9
Japan	55.8	488.1	11.4
United States	106.2	1,516.3	7.0

Source: United Nations, *Monthly Bulletin of Statistics* December, 1976 Vol. XXX, No. 12, Table 52, pp. 110-117 . . . and International Monetary Fund, *International Financial Statistics* December, 1976, Vol. XXIX, No. 12.

Every nation of the world trades its goods and services for those of other nations. However, the overwhelming majority of world trade is carried on among those countries considered to be developed. Table 4 below shows the disparity.

Table 4. Dollar Value Of Goods And Services Exported And Imported Among The Developed And Less Developed Nations Of The World, 1975 (1)

World Trader	Dollar Value of Goods Exported	Percent of Total World Exports	Dollar Value of Goods Imported	Percent of Total World Imports
Developed Countries	578.6	73.2%	614.3	76.5%
Developing Countries	211.4	26.8%	188.6	23.5%
Of the Developing Countries 30 of the Least Developed Countries (excluding OPEC)	3.0	0.4%	5.3	0.7%
Oil Producing and Exporting Countries (OPEC)	112.0	14.2%	53.1	6.6%

Source: Same as Table 2.
(1) Source excludes data on centrally planned economies.

Even more striking is the fact that when we subtract the effects of the oil producing countries, we see that 30 of the world's least developed countries purchased only about 0.7 percent of the world's imports and they exported only 0.4 percent of all goods and services exported in the world.

Table 5 shows that of all the goods and services exported by the United States, 27 percent goes to Europe, 22 percent to Canada and 16 percent to Asia and the Middle East. Europe does not exhibit the same kind of trading pattern as the United States, since much of the trade there is among European countries. Only about 5.5 percent of Europe's exports find their way to the United States. Table 5 also shows the importance of the United States market to Canadians. Nearly 70 percent of Canada's exports are to the United States. The exports of Asia and the Mideast include large quantities of petroleum, which helps to explain the large share of their exports that goes to Europe, Japan and the United States. The fact that 31 percent of Japan's exports go to Asia and the Middle East shows the importance of Japan as an economic power in Asia. The United States and Europe also represent sizable markets for exporters. The centrally planned economies of the world trade mostly among themselves and with Europe—the percent of their exports going to the United States is very small.

Table 5. Trading Partners Of The World's Largest Traders: The Percent Of All Goods Exported From 8 Parts Of The World To Other Parts Of The World, 1975

Percent of Exports Going to Selected Parts of the World

FROM \ TO	USA	Europe	Canada	Asia & Middle East	South/ Central America	Japan	Centrally Planned & USSR
USA	—	27.3	21.6	15.8	14.8	8.5	3.7
Europe	5.5	**66.2**	1.0	7.6	5.5	1.0	6.5
Canada	68.9	12.8	—	2.8	6.3	6.6	2.8
Asia/Mideast	12.2	35.5	1.9	**17.4**	5.3	19.5	2.2
South/Central America	37.2	23.0	4.4	2.3	**17.3**	3.6	9.3
Japan	24.1	15.7	2.3	30.8	6.8	—	7.9
Centrally Planned Economies of Europe, Asia and USSR	1.1	25.2	0.3	6.9	3.0	2.6	**54.9**
OPEC	14.2	42.3	2.3	9.5	10.1	16.2	1.2

Source for Table 5: United Nations, *Monthly Bulletin of Statistics*, December 1976, Vol. XXX No. 12. Special Table C, p. xviii-xxi

Note: These figures calculated from trading patterns in the 1st half of 1976. The bold numbers show the percent of goods traded by countries amongst themselves who are members of that part of the world.

Once we realize that most trade takes place among developed parts of the world and that development implies industrialization and technology, we might conclude that manufactured goods requiring high levels of technology are exported by developed countries and that the minerals, fuels and cruder materials tend to be exported by the developing nations. The data in Table 6 confirm this assumption.

Table 6: Predominant Product Categories Involved in Trade Among Developed and Developing Parts of the World, 1974

Product	Billions of $ Exported	% Exported by Developed	% Exported by Developing
Machinery and Transportation Equipment	205.9	87%	3%
Other Manufactured Goods	213.2	79%	13%
Mineral Fuels	170.1	16%	79%
Crude Materials	74.9	30%	60%
Chemicals	63.7	89%	5%

Source: United Nations, *Monthly Bulletin of Statistics*, August 1976, Vol. XXX No. 8, Special Table C, p. xxviii to xlv

Conclusion

There can be little doubt that trade among nations constitutes an important activity. Even though only about 7 percent of the demand for U.S. goods and services stems from overseas, for other nations the percent is far higher and world trade becomes for many a source of livelihood.

The governments of the nations of the world keep close track of the amount of goods and services which flow into and out of their borders. For centuries industries have taken advantage of markets for their goods and services beyond their home nation's borders. And in many cases, governments have given preferential treatment to those exporting industries in the hope that new wealth would come to the home nation.

An important element in the world trade arena is the multinational company. In fact, MNCs are sometimes referred to as "engines of world trade" in that they possess the resources and the know-how to assure that the advantages stemming from international trade can be realized.

By the mid-1970's MNCs accounted for about 15-20% of the total *world* production of goods and services. These multinational firms not only sell their products to foreign countries, they also *produce* their products in foreign countries. The remaining sections of this booklet will help us to better understand where these new business enterprises came from, what they do, and how they affect the economy and politics, not only of our country, but also those of the entire world.

SUGGESTED ACTIVITIES, SECTION II

1. Have students compile a list of commodities that the United States must import from other countries and prepare exhibits, bulletin boards and/or reports describing the origin of these products and their uses in the United States.
2. Have students use reference works to find the countries with which the United States trades most and try to explain why these trading patterns exist. Or, students could be asked to select a single country to study.
3. What political and ideological reasons can you give that help to explain why the centrally planned economies of the world export less than 2 percent of their goods and services to the U.S.?

NOTES ABOUT ACTIVITY MASTERS

Activity Master I has several features. One, it will give students the opportunity to see some important facets of world trade as it is carried on by selected countries. It will show those areas of the world which are important to the United States, Europe, Canada, Japan and Asia as trading partners. Students will also get exercise in the use of percentages to calculate the dollar-value of goods exchanged between countries and in the interpretation of "from-to" tables. The map experience will help place geographical relationships in a natural perspective.

SECTION III—BRIEF HISTORY OF MNCs

What You Can Expect To Learn In Section III

1. Historical forerunners to present-day multinational corporations.
2. Formal definition of a multinational business.
3. The dimensions and manifestations of the existence of MNCs.

NOTES FOR THE TEACHER ABOUT SECTION III

Trade among the nations of the world arose from the desire of business enterprises to sell their goods and services to foreign countries. Trade was a very effective way for countries to exchange that which they had in abundance for that which they could not produce as well as their foreign trading partners. What is new about the current world trading situation is that there now exists a great number of large business enterprises who desire not only to sell their wares in foreign countries but who also find it advantageous to *produce* in foreign countries. Such business enterprises are called multinationals. This section deals with their background, definition and impacts upon world trade.

There are a few key points to keep in mind about Section III. One, the survey of the history of MNCs is brief. Many more facts, dates and places could be added to make the history more complete. The intention in this section, however, is to introduce a working definition of the MNC along with the idea that the MNC is not an entirely new phenomenon. The other point made is that the products which are sold by multinationals are very familiar to us. This section offers an introduction to the question of why some business enterprises choose to supply foreign consumers from production facilities located in the foreign country rather than from the home-base country.

The activities presented at the end of the section are crucial, for they will help students see the breadth, depth and impact of the multinational. The activities will help further to identify products and the many activities of multinationals.

Brief History Of The MNCs

The fact that many corporations have chosen to become multinational is in some ways a revolutionary development. Conventional economic wisdom held that, while raw material and finished goods could be transported easily from one country to another, labor, management and productive and financial capital could not cross national boundaries without great difficulty. The MNCs challenged this assumption by regarding the productive resources of the world as a unit and the people of the world as a single potential market.

For a business enterprise to be considered an MNC, it must have a "significant presence" in a foreign country. While the definition of significant presence differs from industry to industry, and from author to author, it usually includes the existence of at least one production facility in a country different from its "home country." Therefore, by definition, a business enterprise does not become an MNC merely by selling its products in other countries; some more substantial presence is required.

Examples of such a presence are manufacturing plants, mines, farms, sales or financial offices, parts operations and research centers. Other types of presence are also possible, and an MNC might have one, some or all of these kinds of facilities in foreign countries.

The forerunners of the MNCs were the Dutch and English trading companies of the 17th and 18th centuries. They bought and sold goods, but, unlike the modern MNCs, had little or no productive capacity in foreign countries. The Industrial Revolution, which so greatly increased the need of European countries for raw materials, resulted in the establishment of some foreign-owned mines and plantations in a number of non-European countries, but the building and operation of productive facilities in foreign countries was not widespread until the rapid growth of the extractive industries of oil and mining in the early 1900s. Standard Oil, a United States company, and British Petroleum were among the first true MNCs. Mining companies such as Anaconda Copper and International Nickel established significant presences in Africa and South America. They were soon joined by such consumer-based MNCs as Singer, Woolworth and Coca-Cola.

In 1950 the United States had a direct investment overseas of approximately 7.5 billion dollars, mostly confined to oil and mining industries in Canada, Latin America and the Middle East. By 1975 this figure had grown to 133.2 billion. Most of this explosive growth resulted from the activities of the MNCs.

United States corporations, however, are not the only MNCs. Although they account for more than 50 percent of all the world MNCs having sales of over 1 billion dollars, the United Kingdom, France, West Germany, the Netherlands and Japan are home countries for many important corporations doing business on the world market. Indeed, the U.S. is a "host country" for some MNC activity; for example, Volkswagen and Baskin-Robbins. In 1975, foreign countries had a direct investment of 26.7 billion dollars in the United States.

The establishment of such a presence in a host country requires investment in that country, that is, the transfer of financial or productive capital out of one country and into another. The flow of capital to host countries can be seen by observing five different measures of foreign presence: sales, production, employment, assets and the number of host countries where MNCs have facilities located. For example, Standard Oil of New Jersey (now Exxon) in 1971 had the following percentages of its activity accounted for in foreign countries: 50% of assets, 52% of earnings and operations in 25 host countries. The Royal Dutch/Shell Group, a Netherlands-United Kingdom MNC, had 79% of sales and 70% of employment accounted for in 43 host countries. Both Nestle Corporation of Switzerland and British-American Tobacco had approximately 95% of their employment accounted for in foreign countries.

What kinds of products do multinationals produce? Recall that most activity in the developed world deals in manufacturing, mineral, and oil production, which require high levels of technology and productive capital. Therefore, heading the list of the world's largest MNCs are auto, oil and computer companies.

While we have explored the significant worldwide presence that the MNCs have established, irrespective of national borders, we have yet to explore some of the fundamental economic reasons for moving beyond the point of only selling overseas to actually producing overseas. We will be dealing with this question in the next section.

SUGGESTED ACTIVITIES, SECTION III

1. Using the list on Activity Master I, have the students do individual research projects by writing to the headquarters of an MNC on one or more of the following topics:

a. Ask for a list of consumer products that are made by this company. What products do they sell to foreign markets? Are those products made in the United States or in the countries in which they are sold? How do market demands differ in those countries from demand for the same type of product in the United States?

b. Ask in which countries the MNC has production facilities. What factors of production affected the decision of the company to locate there? Are goods produced mainly for the domestic market, the regional market or for shipment to faraway areas? What effect do trade barriers such as tariffs and quotas or local taxes and regulations have on their operation?

c. Select a product that requires complex assembly, such as a television set or automobile. Ask where all the company's assembly plants in various parts of the world are located and what the sales figures are for the product in each country. Make a map showing the locations of the assembly plants. Try to decide whether the product is being assembled for the domestic market or for shipment to a nearby area.

2. Have students log all the products advertised on a TV station within a certain time and determine how many of them are made by MNCs.

3. Invite marketing executives from a local corporation which exports to other countries to come into class to describe their company's operations.

NOTES ABOUT ACTIVITY MASTERS

Activity Master II will provide the students with the opportunity to collect some basic information on MNCs using a readily available primary source of information. The addresses which can be found in *Moody's Industrial Manual* will be useful and complementary to the activities presented in this section and will reinforce the idea that MNCs are well known, extend around the world and are an important economic entity of our time. In addition to finding the address of corporate headquarters, the two volumes of *Moody's Industrials*, available in most libraries, offer a wide range of information about geographic location of production facilities, the kinds of products produced and in some cases even brand names of the products. *Moody's Industrial Manual* is published by Moody's Investors Service, Inc. and comes in two volumes. Volume 1 contains listings for corporations whose names begin with A through I. Volume 2 covers corporations J through Z. The information in Moody's is compiled from a number of different sources, including stockholders' reports and reports submitted to the Securities and Exchange Commission.

SECTION IV—MNCs: AN ECONOMIC UNDERSTANDING

What You Can Expect To Learn In Section IV

1. MNCs exist as the result of the rational response of business to the need for scarce raw materials, to satisfy business desires to produce products at the lowest possible cost and to overcome political and economic barriers to the production and sale of products in foreign countries.
2. Economic concepts such as comparative and absolute advantage and the relationship of these concepts to the cost of production, trade and the multinational corporation.

NOTES TO THE TEACHER ABOUT SECTION IV

Three reasons for the existence of MNCs are discussed in this section together with a discussion of some fundamental economic concepts. The first reason, the geographic scarcity of raw materials, will be easiest to understand and demonstrate. The second, the desire to produce at the least possible cost, is undoubtedly the most difficult for it involves an understanding of comparative advantage, one of the more complex of the economic concepts. This section avoids long, tortuous examples and mathematics that usually accompany a discussion of

comparative advantage. The intent of this section is to help the teacher conceptualize the meaning and significance of comparative advantage. The object is to show that those nations which offer a comparative advantage in the production of some product are ones which are attractive to many corporations because of what comparative advantage implies regarding the cost of producing there compared to somewhere else.

The third item, political and economic barriers, is also relatively easy to understand. In this part the point is made that regardless of the world's needs for raw materials and regardless of where cost of production is least, a government may dictate laws and regulations which supersede the other two factors. This item is among the issues discussed in the last sections and it continues to be a source of argument among many.

SECTION IV—WHY MNCs

The modern multinational corporation has a presence in foreign countries for three basic reasons: 1) to satisfy its and others' needs for raw materials, 2) to produce at lower cost in order to meet competition and to satisfy its customers, and 3) to conform to government policies of the host country.

In the first category, raw materials such as oil, copper ore, bauxite, etc., may not exist in the home country. Or they may be much more expensive to produce in the home country because they are deeper in the ground or are relatively more scarce. Thus, a business enterprise may establish a production facility at the source of these raw materials, thereby becoming a multinational by definition.

The second reason that an MNC may find it can produce at a lower cost in a foreign country than in the home country often is related to transportation costs. A large and complex product, such as an automobile or an industrial machine, is quite costly to ship fully assembled. Often, transportation costs may be significantly reduced if the parts are shipped to the country in which it will be assembled and sold.

But the idea that the cost of producing something can be lowered by producing it in a foreign country is more complex than the two reasons above indicate. In order to fully understand why costs can often be lowered by shifting production from one country to another we must understand the economic concept of "comparative advantage."

To understand comparative advantage, we must consider that all production of goods and services results from the combination of four *factors of production:* land (and the resources derived from the land), labor, capital and management. All of these factors are, to some degree, scarce; therefore, when a producer in a country uses some of these factors to produce one type of good or service, the people in that country must sacrifice other goods or services that could have been produced, using those same productive resources. This is called the "opportunity cost" of producing. For example, when 10,000 automobiles are produced, the opportunity cost is alternative goods or services that could have been produced with the workers, the raw materials, the machines, and the management talents that went into producing those automobiles. The amount of goods and services forgone in order to get autos is opportunity cost.

Very often, a certain type of good may be produced more "efficiently" in one country than in another; that is, the producer can get a maximum number of goods for a minimum input of factors of production. One country may have large, easily accessible amounts of the raw materials needed for production. Or it may have the kinds of labor necessary for a certain type of production; some kinds of production need large quantities of low-skilled labor, while others may need fewer, but more highly educated workers.

When one country has the productive resources which enable a good to be more efficiently produced than in another, we say that it has an *absolute advantage* in the production of that good. It probably would be a good idea if the country specialized in exporting that good in exchange for other goods that it could not produce without a high opportunity cost.

However, often a country can reap the greatest economic benefit if it specializes in producing those goods in which it has a *comparative advantage;* that is, those goods which it can produce most efficiently *relative* to the countries with which it trades.

It is easy to see the principle of comparative advantage in terms of individual decisions. For example, a medical doctor may also be an excellent housepainter. However, if he can make $300 a day by selling his medical services, it is to his advantage to employ someone else, at perhaps $80 a day, to paint his house, rather than to stay home from his office and paint it himself. In the same way, a country will find that it can make the largest total number of goods and services available to its people if productive resources are concentrated on those goods in which the country has a comparative advantage. For example, the United States is the largest grain producer in the world, not only because of excellent growing conditions, but also because of highly mechanized farm production methods. At the same time, although the U.S. produces many automobiles, it also imports many. If the U.S. were to shift some productive resources from grain production into making automobiles, the ultimate opportunity cost would be the loss of some of the grain that is sold abroad. Probably both total world grain production and total world automobile production would tend to go down, since a larger percentage of both would have to be produced by *relatively* inefficient producers. The principle of comparative advantage is illustrated in Activity Masters III and IV.

When comparative advantage is related to the multinational corporation, one can see that a single corporation operating in many countries can often maximize its total profit by shifting production to that host country in which the greatest comparative advantage exists for producing a certain type of good.

Thus far it has been said that the cost of production and transportation costs affect the price at which a product is able to be sold. If consumers are willing to pay this price, then trade between producer and consumer will take place. The laws of economics are fairly straightforward in these cases. Producers will seek out those places where they can produce their products at the least possible cost and where the cost of transporting goods to consumers is lowest because, under such circumstances, producers are able to offer their products at lower prices and thus be more competitive. From the simple law of demand we know that consumers are willing to buy more at lower prices than at higher ones.

However, in many cases governments intervene in the basic process of exchange between producers and consumers—especially when the producers are in one country and the consumers are in another.

Thus, there is a third reason why business enterprises may become multinational—to overcome some of the barriers to trade imposed by governments who attempt to maintain their own self-interest. There are several ways that governments can effect policies that influence a business enterprise.

A government may ban the importation of certain products that it desires to have produced in its own country. Thus, any enterprise which wishes to sell its products in that country must locate a plant in that country, regardless of how much it costs to produce there. While such action might increase the number of jobs in the country, the cost of production and thus the price of the products is likely to be higher than it would otherwise be.

While such action is not very widespread, measures such as tariffs, subsidies and quotas are much more common. A tariff is a sum of money an importer must pay to a government for the right to sell products in that country. Tariffs have the effect of reducing the quantity of foreign goods imported by a country and increasing the price of the product to consumers. Tariffs are frequently used by governments to protect new (infant) industries which have not yet been able to produce very efficiently and which are forced to charge higher prices than their more established foreign competitors. Because tariffs change the prices at which a business is able to sell a product, a business may decide to locate a plant in the foreign country, thereby escaping the tariff.

Quotas, too, can be used to affect trade. Governments may simply say that only so many units of a product can be imported and no more. This decision tends to restrict the supply of a product which may be relatively less expensive than one domestically produced and eliminates the need for domestic industry to engage in full-scale competition with the foreign industry.

Export subsidies are sometimes offered to industries to encourage exportation. Subsidies may be used in those cases where the businesses' cost of production and transport cost (plus, perhaps, tariffs) are such that they are not able to sell at a competitive price in the foreign country. The government thus will agree to help with production costs by, say, not imposing any business taxes on goods which are exported.

One of the most important reasons that many multinational corporations give for locating production plants in foreign countries is that foreigners must export goods and services to obtain the money needed to pay for imports. If a country cannot produce enough exports to pay for imports, it runs a balance of trade deficit. When the deficit becomes large enough, the country no longer can borrow money from international banks to finance import payments. At that point, if the multinational corporation wishes to continue to sell in that country, it must establish a production plant using that country's factors of production and selling its output to the people of the country in exchange for that country's currency. Thus, the market can be served without importing.

The increased income earned by workers in the new plant may even make it possible for the country to buy more of other imports. In fact, many economists credit multinational investment in developed and underdeveloped countries with greatly increasing world trade and actually creating more export jobs in home countries than are lost through establishing production facilities in host countries.

We should consider transportation costs as legitimate expenses in calculating comparative advantage. However, when country A uses tariffs, subsidies and other trade restrictions to encourage domestic production contrary to comparative advantage, both country A and all other countries may be worse, rather than better off. In the country which restricts trade, consumers will be paying higher prices than they should for products but will have jobs. Consumers in other countries may have lower priced products but no jobs, unless they can get them in non-import-competing industries. But worst of all, production will be inefficient. That is, total world production will be less that it could be.

It is for these reasons that GATT (General Agreement on Tariffs and Trade) was established after World War II. Negotiations under the GATT have resulted in a steady reduction of tariffs, subsidies, quotas and other trade distortions. Trade negotiators from many countries are continually meeting to eliminate government and business practices contrary to the principle of comparative advantage.

SUGGESTED ACTIVITIES, SECTION IV

1. Have each student bring in two products produced in a foreign country which are in everyday use. Divide the chalkboard into five sections: "Western Europe," "Eastern Europe and Russia," "Africa," "Latin America," and "Far East." List each item in the appropriate column, followed by the specific country of origin. Discuss why each might be imported from that country to ours, giving such reasons as resources found in that country, cost of production, state of technology, and proximity to the United States. Discuss the reasons why we trade with some areas of the world more than with others.
2. Suggest that a student committee write a skit about the problems connected with world trade, comparative advantage, opportunity cost, etc. and select other class members to act out the skit before the class.
3. Set up a debate on the following topics:
   a. Should an infant industry be protected by a high tariff?
   b. Should the U.S. impose high tariffs on foreign cars?
   c. Should the U.S. strive for self-sufficiency and avoid all world trade? Remember the principle of comparative advantage. If we replaced all the products we presently import with the same type of products produced in the U.S., do you think prices for these goods would be higher or lower than they are at present? Would the restriction of imports be of benefit to you as a consumer? Do you think the U.S. has benefited from the increases in trade or has it been hurt? How would foreign countries obtain the money to buy our exports if we did not buy their imports? How would you compare the number of jobs lost in the U.S. because of imports to the number of jobs created in export industries?

NOTES ABOUT ACTIVITY MASTERS

There are five activity masters which relate to the section on *Why MNCs*. Master III is intended to demonstrate the benefits that can be obtained if countries specialize in those products in which they have a comparative advantage. Master IV relies on calculations made in Master III. In it is demonstrated that specialization in line with comparative advantage leads to lower costs of production as well as more products. Master V explores some further issues regarding the reasons for the existence of multinational enterprises. Activity Masters VI and VII explore the effects of trade barriers upon market price and the location of multinational enterprises.

SECTION V—SOME ISSUES RAISED BY MNCs

What You Can Expect To Learn From Section V

1. The growing importance of multinational corporations has raised a number of complex economic, social, political and legal questions—and in recent years there have been a number of individual and institutional inquiries in this area. Many studies . . . both "pro" and "con". . . have been based more on emotion than on fact, however, and have resulted in widespread misunderstanding of the critical issues involved.
2. Not all companies or countries reap an immediate benefit from the MNCs' quest to locate production facilities where they can operate most efficiently and at the lowest cost. One company's, or country's, gain due to superior resource endowment or efficiency may be viewed as another company's or country's loss. For the company or country that is displaced by the more efficient competitor, the transition period can be a traumatic experience.
3. The existence of MNCs gives rise to issues that transcend economics.

NOTE TO THE TEACHER ABOUT SECTION V

As might be expected, the presence in a country of corporations which have homes in other countries has given rise to a host of questions about allegiance, political and economic power and social responsibility. This section attempts to present some of the more common elements of the discussion about these issues. The teacher should find the material in this section excellent for prompting critical appraisal of the issues from several different perspectives.

SECTION V—ISSUES RAISED BY THE PRESENCE OF FOREIGN OWNED AND CONTROLLED ENTERPRISES

Hardships of Transition

Economists are always reminding us that "we can't get something for nothing." Although world output is increased and all countries are ultimately better off when world trade takes place in accordance with comparative advantage, there are costs.

Companies that can compete effectively in world markets increase in size and hire more workers. These companies, their workers, and worldwide consumers benefit. Companies that cannot compete with imports that are either higher in quality or of lower cost may lose business and their workers may lose their jobs. Only the most efficient of these companies can survive worldwide competition. If the workers who lose their jobs can be retrained and placed in industries that remain competitive, the problem will resolve itself. However, the transition can be a trying experience, especially for older workers whose mobility and retraining possibilities are more limited. A further complication arises if the company that cannot compete happens to be in a country that already has a severe unemployment problem. These short-term hardships of change must be weighed against the long-term gains to consumers on a worldwide basis.

Another potential problem is that trade may not occur in accordance with comparative advantage because of political and other interference in international markets. In that case we may endure the hardships of adjustment without realizing the benefits of increased efficiency.

The MNC and the discussions which surround it go far beyond economics and questions of efficiency. The remainder of this section gives the reader an idea of the nature and complexity of the many unresolved issues surrounding MNCs today.

These issues revolve around the law, social responsibility, political and economic power and national allegiance.

The Law and Multinationals

The home countries of MNCs often enact laws which offend other countries and complicate the lives of MNCs. In the United States, for example, as Rolfe states, "American authorities have often reached into foreign countries to prosecute not only American corporations but European corporations in violation of United States law as well, particularly those which operate subsidiaries within the United States."*

U.S. laws also require that foreign subsidiaries of American companies conform to various regulations pertaining to how much they can invest abroad and how much of the profits they must bring back to the United States. Needless to say, such regulations are often found offensive by foreign host nations.

*Sidney Rolfe, "The Multinational Corporation," *Foreign Policy Association* Hadlin Series No. 199: (New York, 1970) p. 23.

THE QUESTION OF RESPONSIBILITY AND THE MULTINATIONALS

There are three related parts to the problem of social responsibility and the multinational. The multinational corporation exists in many countries. Shareholders live in many different nations, but generally in the developed countries. Because of these facts, the multinational corporations have been faced with the following situations which represent a critical problem.

To which country does an MNC have a responsibility? One might say, "To the home country." But does it not follow that the MNCs also have a responsibility to the host country? Furthermore, many of the stockholders of MNCs are foreigners whose values may be different from those of the home country. Does the MNC have a responsibility to them also? What should the MNC manager do regarding a "customary and ethical" practice in one nation that may be "immoral and illegal" in another? These questions are at this very moment being grappled with by MNC executives, politicians, academicians, and the general public.

There is one further aspect of the responsibility question—one that has been around since the earliest of the "extractive" MNCs. Extractive companies, seeking the most economical resources, found them in the rich deposits of what we now call the developing nations. We have already seen from trade patterns that the developing countries export a high percentage of minerals and other crude materials. Often these nations had only one of the four factors of production: the land. The result, of course, was that the labor, capital and management factors all had to be brought in by the interested firm. The nation from whose territory the commodity was being shipped, then, not only saw the material being exported to serve the needs of the industrial economies, but also saw the developed nations profiting by the utilization of their own labor, capital and management. On the other hand, had the developing nations chosen not to allow their resources to be developed in this manner, the capital needed for their own development might never have become available.

Furthermore, the relatively unstable political situation in many less developed nations has tended to increase an already existing fear of foreign economic domination. Some political leaders have noted that the output of some large MNCs exceeds the gross national product of many of the world's smaller nations.

One response of some developing nations is simply to expropriate the holdings of foreign corporations in their borders. The 1977 International Economic Report of the President points out that a total of 144 expropriation disputes occurred (53% in Latin America and 20% in the Middle East). Although many such disputes are settled through negotiation, many more are not, because of an inability to concur on what is "just compensation" for the property.

Such possibilities increase the risk of producing in developing countries and heighten the chance of governmental confrontation—neither of which aids developing nations in moving themselves into the ranks of the developed. But the expropriation response does emphasize that the national sovereignty of a less developed country can be a potent weapon, no matter what the size of the MNC involved.

A final issue, of recent concern, involves the establishment of assembly or sub-assembly plants in towns on international borders. By this practice some businesses take advantage of inexpensive labor in a foreign country and in the process may add to unemployment in the home country.

Our previous discussions of world trade should make clear that responsible behavior on the part of MNCs and home and host countries benefits all parties. And in most cases such cooperation does occur. We tend to hear mainly about the "horror" stories where either one side or another does not act responsibly. It is hoped that, as a result of this discussion of world trade and MNCs, students will realize that the rise of MNCs has produced many benefits and has created a number of new problems. And, being aware of the costs and benefits, students should be able to better analyze possible approaches to solving the problems without losing the benefits.

Suggested Activities, Section V

1. Conduct a role-playing situation in which one group of students represents an MNC that wants to explore for oil in a developing nation. Another group of students represents government officials with whom the company must negotiate. The two groups should work out an agreement about the terms and conditions under which the MNC will operate in the host country. Areas of concern might be taxes, subsidies, labor conditions, etc.
2. Conduct a panel discussion on whether United States consumers should buy only products made in the United States. Have students research and play such individual roles as a worker in a United States clothing factory, a business executive for a United States-based MNC, a United States retail store executive, an unemployment counselor and a United States consumer.
3. Have each student select a country and study the good and bad effects that MNCs have had on its economy.
4. Discuss the good and bad effects of the increase of imported cars on the United States economy.
5. The General Agreement on Tariffs and Trade (GATT), in which U.S. participation has been approved by Congress to promote world trade, has been accompanied by concurrent legislation providing funds for job retraining, job relocation, and unemployment compensation for workers affected by increased imports. Have a class discussion on whether the government should provide this kind of help, whether it can afford such measures, and whether this approach is better than a policy of restricting imports.
6. Executives for United States firms have found that a widespread practice in some host countries is to bribe government officials or local business people in order to receive favorable treatment. Discuss this topic in class or have a few students prepare a debate, panel, or skit.

Activity Master I

Major World Trading Partners

Exporters	1975—Percent of Total Exports Going To				
	U.S.	Japan	Canada	Western Europe	Asia/Middle East
U.S.	—	8.5	21.6	27.3	15.8
Japan	24.1	—	2.3	15.7	30.8
Canada	68.9	6.6	—	12.8	2.8
Western Europe	5.5	1.0	1.0	66.2	7.6
Asia and Middle East	12.2	19.5	1.9	33.5	17.4

Using the table, fill in the blanks below

Percent of total United States exports going to:

- Japan 8.5%
- Canada 21.6%
- Western Europe 27.3%

Percent of total of other countries' exports going to U.S.:

- Canada 68.9%
- Western Europe 5.5%
- Japan 24.1%

Percent of total European exports which go to Japan 1.0%

Percent of total Japanese exports which go to Western Europe 15.7%

Percent of total Japanese exports which go to Asia and Middle East 30.8%

Percent of total Asia and Middle East exports which go to Japan 19.5%

Using the above results, fill in the arrows to the right and then calculate the $ value of goods traded among the parts of the world shown on the map.

NOTE: Answers to questions on spirit duplicating masters appear on this, the teacher's side, of the sheet only. They will not be reproduced on student copies.

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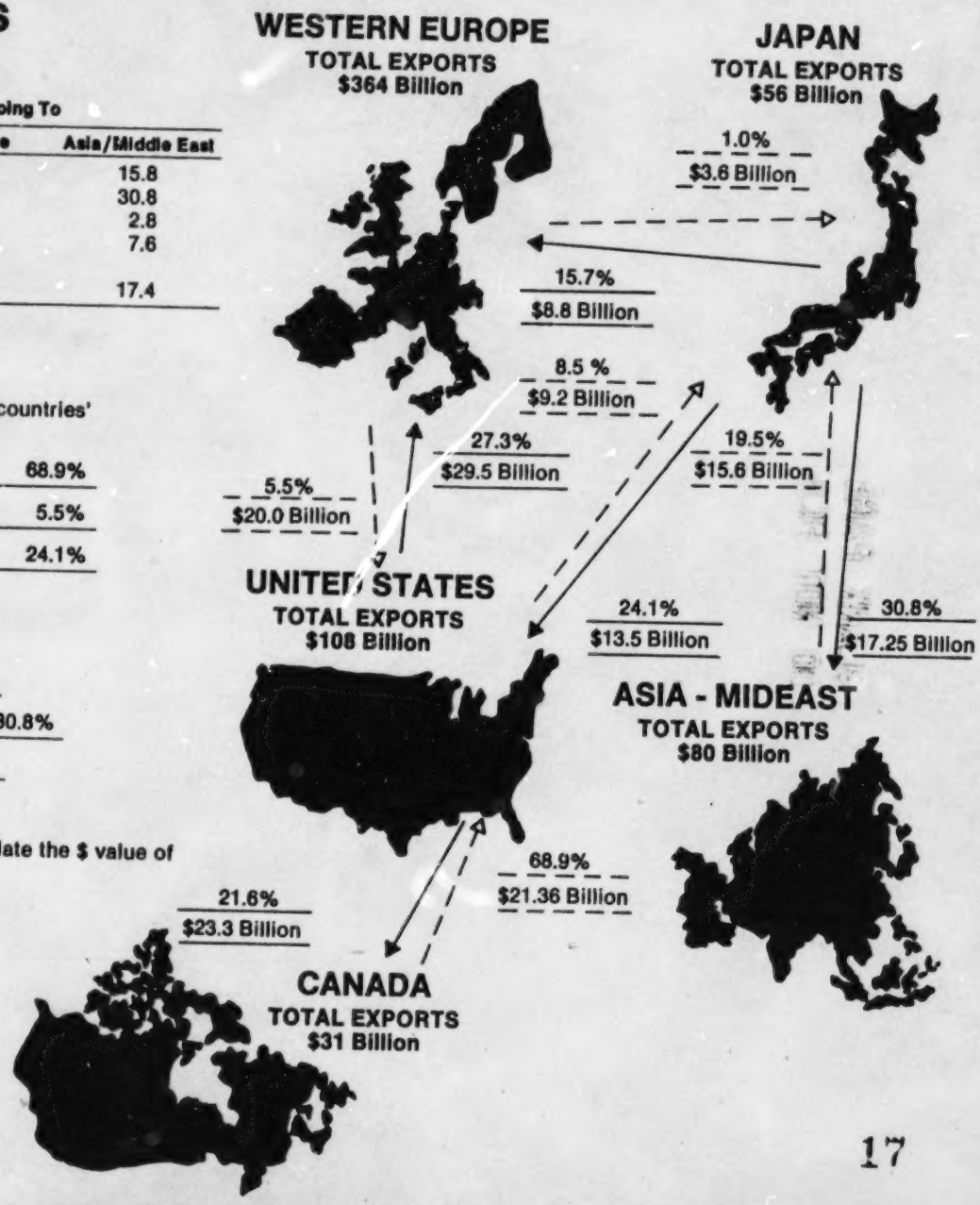

Activity Master II

Who Are the MNCs and Where Are Their Homes?

Below is a list of some of the largest multinational corporations. Fill in the addresses of the general offices of the multinational corporations which can be found in **Moody's Industrial Manual Vol. I and Vol. II.**

General Motors Corporation Del.
3044 W. Grand Blvd.
Detroit, Mich. 48202

Daimler-Benz A.G. West Germany
Mercedesstrasse
Stuttgart-Unteruerkheim Germany

Mobil Corporation Del.
150 East 42nd Street
New York, N.Y. 10017

Caterpillar Tractor Co. Cal.
100 N.E. Adams
Peoria, Ill. 61629

Union Carbide Corporation N.Y.
Union Carbide Building
270 Park Ave.
New York, N.Y. 10017

Philips Lamp Works Netherlands
Eindhoven
The Netherlands

Nestle Alimentana S.A. Switzerland
Vevey
Switzerland

Hitachi Ltd. Japan
No. 5-1
1 - chome
Marunouchi Chi-Yoda-Ku
Tokyo, Japan

Goodyear Tire and Rubber Co. Ohio
1144 E. Market Street
Akron, Ohio 44316

Exxon Corp. N.J.
1251 Avenue of the Americas
New York, N.Y. 10020

Unilever Ltd. Great Britain
Unilever House
Blackfriars
London C4P 4BQ

Volkswagenwerk A.G. West Germany
Wolfsburg, Germany

Sony Corporation Japan
7-35 Kitashir agawa
6-chome Shi agawaku
Tokyo, Japar

British Petroleu n Comp ny, Limited
United Kingdom
Britannic Hous e
Moor Lane, London EC2Y9BU

Dunlop Holdings, Ltd. United Kingdom
Dunlop House
Ryder Street
St. James, London S.W. 1

Siemens Aktiengesellschaft
West Germany
Wittelsbacherplatz
Muenchen, Germany

Procter & Gamble Co. Ohio
1301 East Sixth Street
Cincinnati, Ohio 45202

Which foreign-based MNCs above have production sites in the U.S. and where are they located?

Dunlop—Hartwell, Georgia, and Huntsville, Alabama

Siemens—Scottsdale, Arizona, and Cheshire, Connecticut

Volkswagen—Jacksonville, Florida, and New Stanton, Pennsylvania

Sony—San Diego, California

List common products produced by MNCs that are sold in the U.S.—for as many MNCs as you can.

Canned fruits and vegetables

Chocolate drink mix

Tennis balls

Margarine

Electron tubes

TVs—Radios

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Activity Master III

The Benefits of Specialization and World Trade

Pacifica and Atlantica are two make-believe parts of the world. There are two business enterprises in each country—one producing bicycles and the other producing TVs. The businesses in Pacifica find that the following situation exists, as shown in Table 1.

TABLE 1: THE NUMBER OF BICYCLES AND TVs THAT CAN BE PRODUCED IN PACIFICA AND ATLANTICA FOR ONE DAY'S WORK.

	Bicycles	TVs
Pacifica	6	2
Atlantica	3	4

Recall the definition of comparative advantage (see pages 27 and 28 in text). Which country has a comparative advantage in the production of bicycles? Of TVs?

Assume that each country has 7 working days per week. If in both countries 4 days were devoted to bicycle and 3 to TV production, what would the outcome be in terms of total bicycles and TVs produced? Fill in the following chart.

CHART I. BICYCLE AND TV PRODUCTION WITHOUT SPECIALIZATION

	Pacifica		Atlantica		Total / 2 Countries	
	Bicycles	TVs	Bicycles	TVs	Bicycles	TVs
Work days devoted to production	4	3	4	3	8	6
Number of units produced	24	6	12	12	36	18

Suppose that all businesses producing bicycles moved their facilities to Pacifica and all TV production moved to Atlantica. Thus, all bicycle production is specialized in Pacifica and all TVs are produced in Atlantica. Fill in Chart II.

CHART II. BICYCLE AND TV PRODUCTION AFTER SPECIALIZATION

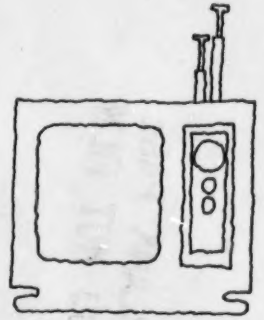
	Pacifica		Atlantica		Total / 2 Countries	
	Bicycles	TVs	Bicycles	TVs	Bicycles	TVs
Work days devoted to production	7	0	0	7	7	7
Number of units produced	42	0	0	28	42	28

Questions about the benefits of bicycle and TV production after specialization:

1. Why was it better for Atlantica to produce TVs than for Pacifica? Because Pacifica has higher opportunity cost for TVs in terms of bicycles which must be given up.

2. Did specialization in producing bicycles and TVs in those countries having a comparative advantage in their production result in any measurable benefits? Total world production of both goods increased with no increase in days worked.

3. How many additional bicycles and TVs do we have now? Suppose Pacifica wants TVs and Atlantica bicycles—how can they get them? 6 more bicycles, 10 more TVs—they can trade for what they do not have.



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The Relationship of Efficiency to Cost of Production

We will assume in this exercise that the only cost of production is wages and salaries, that is, money payment to the productive factor, labor, and that it takes $100 to hire the labor needed to work one day in Pacifica and Atlantica. Suppose we had the situation described in Chart I in Master III, where both bicycles and TVs were being produced in both countries. How much is it costing to produce one bicycle and one TV in each country? Find the answer by filling in the following charts.

TOTAL BICYCLE PRODUCTION BEFORE SPECIALIZATION (See Chart I, Master III)

Country (Column 1)	No. of Bicycles (Column 2)	No. of Days Worked (Column 3)	Total Production Cost (Column 3 x $100/day) (Column 4)	Production Cost per Bicycle (Col. 4 ÷ Col. 1) (Column 5)
Pacifica	24	4	$400	$16.67
Atlantica	12	4	$400	$33.33
Total	36	8	$800	$22.22

TELEVISION PRODUCTION BEFORE SPECIALIZATION (See Chart I, Master III)

Country (Column 1)	No. of Televisions (Column 2)	No. of Days Worked (Column 3)	Total Production Cost (Column 3 x $100/day) (Column 4)	Production Cost per TV (Col. 4 ÷ Col. 1) (Column 5)
Pacifica	6	3	$300	$50.00
Atlantica	12	3	$300	$25.00
Total	18	6	$600	$33.33

BICYCLE AND TELEVISION PRODUCTION AFTER SPECIALIZATION (See Chart II, Master III)

Country (Column 1)	No. of Units (Column 2)	No. of Days Worked (Column 3)	Total Production Cost (Column 3 x $100/day) (Column 4)	Production Cost per Unit (Col. 4 ÷ Col. 1) (Column 5)
Pacifica	42	7	$700	$16.67
Atlantica	28	7	$700	$25.00

	TOTAL BICYCLES PRODUCED	PRODUCTION COST PER BICYCLE	TOTAL TVs PRODUCED	PRODUCTION COST PER TV
Before Specialization	36	$22.22	18	$33.33
After Specialization	42	$16.67	28	$25.00

What happened to the amount produced and the cost of producing bicycles and TVs as a result of specialization which occurred in line with comparative advantage? Both are being produced at the least possible cost.

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Why Business Enterprises Become Multinational

1. Suppose that in addition to Atlantica and Pacifica there existed a third hypothetical country—Caspian. In Caspian, one firm exists that produces bicycles and another that produces TVs. Both are selling their products in Caspian only. Using the information from Activity Master IV, answer the following questions.

   a. Suppose the Caspian bicycle firm had the same production costs as Pacifica ($16.67 each) and wished to sell bicycles to Atlantica. However, Caspian is some distance from Atlantica and has to pay for the packing and shipping services to transport its bicycles to Atlantica in the amount of $5 per bicycle.

   Suppose that production cost plus a $1 profit is essential to the survival of the business, then what is the lowest price that Caspian bicycle producers can charge the citizens of Atlantica and still cover costs? $22.67

   Is this price higher or lower than what citizens of Atlantica would have to pay if they decided to produce their own bicycles? Lower--$22.67 compared to $33.33

   b. If the Caspian bicycle firm wanted to build another new plant in another country to serve a larger world market, where would they be more likely to build it, Atlantica or Pacifica? Pacifica

   Why? lower production cost

   c. Suppose the government of Atlantica says that its citizens cannot purchase bicycles from any foreign company if they were produced in a foreign country. What might the Caspian bicycle company do about its decision to locate another new plant? If the Caspian bicycle company wanted to meet the demands for bicycles in Atlantica, they might open a plant there.

   How much do the citizens of Atlantica now have to pay for bicycles? $33.33

   d. Suppose the Caspian TV producer wishes to sell his TVs in Atlantica which has a growing market at the price of $25.00. Of course, once again Caspian is some distance from Atlantica and a $10 transport charge will be required to get TVs safely to the Atlantica market.

   What is the lowest price the Caspian firm can charge? $35.00

   How does this compare to the price charged by the Atlantica TV producers? higher

   How successful is the Caspian firm likely to be in the new market? Will not sell as many TVs at higher price.

   What are some of the alternatives open to the Caspian firm? Establish plant in Atlantica.

   How do you think the Atlantica consumers and producers would feel about the various alternatives? Consumers want best products for lowest possible price. Producers want to satisfy demands of consumers and make a profit.

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Activity Master VI

Barriers to Trade--Tariffs and Export Subsidies

As president of Caspian Rock Records, you want to build another plant to satisfy growing world demand for rock music. Your choice of plant location is influenced by the costs of the factors of production—land, labor, capital—in relation to the quantity of records they can produce. Of course, management must also pay itself. Suppose the following chart shows the cost to the manager of hiring the needed amounts of productive factors in four hypothetical countries. Calculate total cost of production and cost per album.

Factor of Production	Pacifica	Mediterrania	Atlantica	Caspian
Land	$200	$150	$100	$100
Labor	$450	$400	$350	$300
Capital	$100	$100	$100	$100
Management	$150	$200	$150	$150
Total cost of production	$900	$850	$700	$650
Total albums produced	100	100	100	100
Production cost/album	$9.00	$8.50	$7.00	$6.50

The biggest market for rock music is in Atlantica where rock music fans are willing to pay up to $7.25 per album. Caspian Rock Records is considering entering the Atlantica market but realizes that if records are produced in Caspian they will have to be shipped to Atlantica. Suppose shipping charges were $1.00 per album. What would be the minimum price that Caspian Rock Records could charge? $7.50

Would there be an incentive for Caspian Rock Records to build another plant in Atlantica to satisfy the Atlantica market?
Yes

The Question of Tariffs

The workers of Mediterrania are faced with unemployment in the rock record industry because Caspian Rock Records can produce in Caspian for $6.50, pay $1.00 to ship the records to Mediterrania and sell them to Mediterrania rock fans who are willing to pay up to $8.50 for rock albums. The owners of Mediterrania record stock are concerned that they are not receiving dividends and interest payments since the plants are closed. These two groups bring pressure on the legislature and $1.75 tariff duty is levied on each record album brought into the country. Calculate the delivered TOTAL COST of the albums produced in Caspian, shipped to Mediterrania and sold there. What would be the new minimum selling price of record albums on Mediterrania? 6.50 + 1.00 + 1.75 = 9.25

Who benefits from this tariff? Rock record producers

Who loses as the result of this tariff? Rock record consumers

The Question of Export Subsidies

As you have seen it is the delivered price including tariffs and transportation costs that is important in determining where to produce. Suppose that the people of Pacifica wanted to stimulate the production of records and compete in world markets. Suppose they saw the market in Mediterrania and that their delivered price was $10.50, compared to an $8.50 delivered price for their competitors. The government of Pacifica decides to grant a subsidy to their record producers for each record album exported. How much of an export subsidy is required to capture the Caspian market?
$2.00 plus

Who will benefit from the subsidy? Pacifica workers, Caspian consumers

Who will lose as a result of the subsidy? Pacifica taxpayers, Caspian workers

Is the subsidy a good idea? Yes or No, and Why?

Let students discuss benefits and costs of this policy from standpoint of consumers, producers, government and citizens in general.

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Government Policies and MNCs

1. If you were a Caspian Rock Records Company manager who knew that the Pacifica market was very important, what would your feelings be about the following two resolutions and what company action might you take and why?

The production of rock records in Pacifica is a relatively new industry which is trying both to export records and satisfy the demands of the home market for them. The demands are high and the price that Pacificans are willing to pay for albums is relatively high. The government of Pacifica fears that the high market price for albums will be such an incentive to producers located in other countries that a flood of lower priced albums will destroy its own record industry, thus causing large scale unemployment. The government, therefore, is considering the following two propositions.

Resolution 1

The importation of rock records is to be reduced to ½ the average number imported over the last five years.

Resolution 2

Record albums not produced in Pacifica cannot be sold to citizens of Pacifica.

2. Discuss the relative merits of each proposal with respect to consumers of record albums in Pacifica and workers in Pacifica. Then discuss the relative merits of the proposed actions on your Caspian Rock Record Company in Caspian and Pacifica.

(list some of the points to be discussed)

3. Can you list examples of actual resolutions similar to the fictitious ones above? Steel import quotas, TV set quotas, shoe quotas

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Activity Master VIII

Thinking About the Benefits and Costs of MNCs

1. In the middle 1970s there were about 400 multinational corporations around the globe. Approximately 300 had headquarters in the United States. These 400 MNCs produced about 15 percent of the gross world product (GWP is the gross national product of all nations added together).

   What are some important economic advantages and disadvantages of 400 companies producing 15 percent of the total Gross World Product?
   Economic Advantages Efficiency and lower costs.

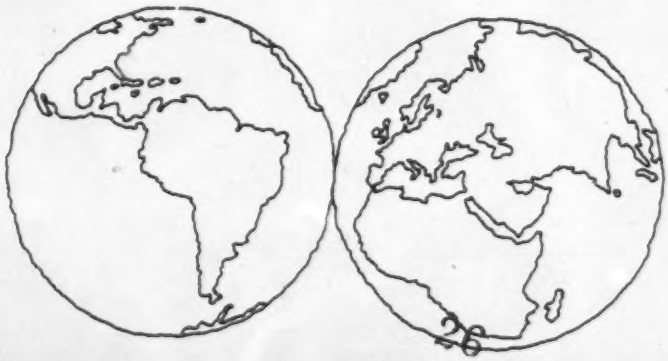
   Economic Disadvantages Loss of national control and increase of economic power of MNC.

2. Recently Sony, a Japanese electronics MNC, built manufacturing facilities in California. What might be some reasons Sony did this? Cheaper transportation costs—no tariff—cheaper production.

   Do you think Sony's action helped or hurt employment in Japan? Why? Short-term dislocations may occur, but the long-term result may be added employment, in accord with law of comparative advantage.

3. Suppose a particular MNC had plants employing thousands of people in several different countries. Each plant in each foreign country employed the nationals of that country. You are the manager and you have to act on the following issue: should each plant be managed according to the rules, customs and codes of the country in which the plant is located or run according to the rules, customs and codes of the home country? Discuss the pros and cons of each.

   list pros and cons and points to be discussed



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Pretest

Instructions: For the statements 1 through 10,
Circle T if it is mostly correct.
Circle F if it is mostly wrong.

TRUE-FALSE:

(T) F 1. People benefit in both countries when two countries trade.

T (F) 2. No trade will take place between two countries if one country makes most things at a lower cost than the other.

(T) F 3. An *importing* country gets goods or services from another country.

T (F) 4. World production is higher without trade than with it.

(T) F 5. Political instability reduces the likelihood that MNCs will invest in a country.

(T) F 6. The factors of production are land, labor, capital, and management.

T (F) 7. Trade is of equal importance for all nations.

(T) F 8. Most international trade is among developed nations.

(T) F 9. United States corporations account for most of the sales by all multinational corporations.

(T) F 10. International trade allows people to obtain goods and services their own country does not have.

Instructions: For the questions 11 through 15, circle the letter corresponding to the most nearly correct answer.

MULTIPLE CHOICE:

11. Expansion by companies into foreign countries will usually
    a) benefit the home country
    (b) benefit both countries
    c) benefit the host country
    d) benefit neither country

12. Which of the following areas consists mainly of host countries?
    a) North America
    b) Asia
    c) the Northern Hemisphere
    (d) the Southern Hemisphere

13. To which country does a multinational corporation have a responsibility?
    a) its home country
    b) its host country
    c) neither country
    (d) both countries

14. Which is the most important item to be used in deciding if a corporation is to be called "multinational"?
    a) Sales in a foreign country
    b) Research centers in a foreign country
    (c) Production facilities in another country
    d) Having shares of stock held by citizens of foreign countries

15. Opportunity cost is an economic concept which states that
    a) Every opportunity has a cost
    (b) The real cost of something is what you have to give up to get it
    c) The real cost of something is the price written on the tag
    d) None of the above

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Master X

Post-test

Instructions: For the statements 1 through 10,
Circle T if it is mostly correct.
Circle F if it is mostly wrong.

TRUE-FALSE:

(T) F 1. Whenever people voluntarily exchange goods or services both parties can gain.

(T) F 2. Trade between two countries can take place even if one country makes everything at a lower cost than the other country.

T (F) 3. An *exporting* country gets goods or services from another country.

T (F) 4. More world trade means less will be produced in the world.

T (F) 5. The United States is primarily a host country.

(T) F 6. Transportation costs are an important factor in the location of industry.

(T) F 7. Many American jobs depend on the sale of our goods in other countries.

T (F) 8. International trade has about the same importance for all nations.

(T) F 9. International trade allows people to obtain goods and services their own country does not have.

T (F) 10. A business enterprise is called "multinational" primarily because it sells its products in some other country.

Instructions: For the questions 11 through 15, circle the letter corresponding to the most nearly correct answer.

MULTIPLE-CHOICE

11. In the last 25 years world trade has
    a) decreased
    b) stayed about the same
    c) increased slowly
    (d) expanded rapidly

12. When a country cannot sell enough exports to pay for its imports, then it
    a) has a comparative advantage
    (b) runs a balance of trade deficit
    c) has a relative advantage
    d) must go bankrupt

13. If a country becomes a host to a multinational corporation, the benefits will usually come to
    a) the home country
    b) the host country
    (c) both countries
    d) neither country

14. Comparative advantage is an economic concept which
    a) Can be used to determine in which goods a country should specialize
    b) Suggests that it is better for a medical doctor, who is also a good housepainter, to hire someone to paint his house
    (c) Both of the above
    d) None of the above

15. Which is the most important item to be used in deciding if a corporation is to be called "multinational"?
    a) Having shares of stock held by citizens of foreign countries
    (b) Production facilities abroad
    c) Research centers in a foreign country
    d) Sales in a foreign country

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Glossary of Concepts and Terms

World Trade—The exchange of goods and services across national boundaries.

Exports—Goods and services produced in a country and sold outside its boundaries.

Imports—Goods sold in a country which have been produced in another country.

Production—The use of production factors to produce goods and services which have value.

Specialization—Engaging in those productive activities to which individuals or organizations or nations are particularly well suited because of some special talent or natural resources endowment.

Scarcity—The physical limitations imposed upon people's desire to satisfy wants which are insatiable. Laws of time and space make it impossible to satisfy all wants, not to mention that people's wants are continually increasing and/or changing.

Productive Resource—The catch-all term for all things that can be used to ultimately produce goods and services to meet the wants and needs of man. The productive resources are usually broken down into *land, labor, capital,* and *management* with all four sharing the characteristics of being scarce and having alternative uses.

OPEC—The Organization of Petroleum Exporting Countries (Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libyan Arab Republic, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, Venezuela).

Developed Countries—Countries typified by industrialized production, advanced technology.

Developing Countries—Countries which do not have much industrialized production compared to their production of raw materials and agricultural products.

Centrally Planned Economies—Systems where productive resources respond primarily to meet the wishes of government planners (e.g., Russia, China, etc.).

Market Economy—A system where productive resources respond to meet the wishes of individual producers and consumers, with government playing a minimal role in the actual market for resources and goods and services.

Opportunity Cost—The value of what has to be given up when choosing one thing over another.

MNC—Multinational corporation. A business enterprise which has a significant presence in more than one country. Generally in order to be considered an MNC, production facilities in more than one nation are required. But other types of presence such as research and administration can qualify an enterprise as an MNC if they are a significant portion of total corporate activity.

Home Country—The nation which a business enterprise calls home—regardless of the amount of its production, distribution, marketing or administrative activities which take place in other countries.

Host Country—The nation in which a production facility is located even though the home facility is located in another country.

Foreign Investment—The act of using the productive resource "capital" to expand production potential in a foreign country. Several ways of investing are possible but all generally involve the transfer of financial capital (money purchases) from the home country to another. Foreign investment ultimately results in the formation of physical capital such as tools, equipment, factories and the like. Money can be used to purchase capital goods in the home country which are shipped to the host country for expansion of productive capability, or money can be transferred and capital goods purchased in the host country.

Comparative Advantage—Results from the fact that a particular country is comparatively more efficient at producing a good than another country. This results in the opportunity cost of the good being greater in one country compared to the other.

Benefits of Trade—The amount of additional goods and services made possible because nations specialize in the production of those goods they produce best and then trade the goods they produce for those they do not.

Import Tariff—An amount of money the government of a country collects for allowing goods to be imported into a country.

Customs Union—A group of countries which band together to eliminate tariffs between them while establishing a common tariff against all other countries (e.g., The European Economic Community—EEC).

Quota—A limit placed by a government on the quantity of foreign produced items that may be imported.

Export Subsidy—An inducement by a government to home producers so that they may be able to compete with others in the foreign market even though their cost of production may be higher.

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Further materials relating to teaching economics are available through the Joint Council on Economic Education; 1212 Avenue of the Americas; New York, New York 10036.

The material in this booklet resulted from the combined efforts of a group of professional economists, curriculum developers and experienced classroom teachers. The authors listed below hope these materials provide teachers and students alike with meaningful information and activities to better comprehend several of the complex economic problems facing our nation today.

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